IN THE

Supreme Court of the United States

October Term, 1974

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Nos. 74-157 and 74-647

UNITED HOUSING FOUNDATION, INC., *et al.*,
Petitioners,

v.

MILTON FORMAN, *et al.*,
Respondents,

and

THE STATE OF NEW YORK and THE NEW YORK STATE HOUSING FINANCE AGENCY,
Petitioners,

v.

MILTON FORMAN, *et al.*,
Respondents.

REPLY BRIEF FOR PETITIONERS UNITED HOUSING FOUNDATION, INC., *et al.*

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Preliminary Statement

This case involves cooperative memberships in a state-subsidized and regulated non-profit middle income housing development. The issue before this Court is whether these memberships are securities under federal law. The case has come to this Court on petitioners' threshold motions to

dismiss the complaint for lack of federal subject matter jurisdiction. The merits of respondents' claims have not been litigated by the parties and both Courts below expressly disclaimed any inferences with respect to the merits (P-A 8 and n. 4, P-A 22; P-B 12 n. 28).

Nevertheless, the respondents devote more than one-third of their brief to a detailed description of the alleged merits of their case. That description distorts the record, and is filled with hyperbole, misstated facts and scurrilous charges. Prefacing their "facts" with the statement "that there can be no dispute as to the facts" (Resp. Br. 4), respondents spin a tale about how officials of the State of New York and its Housing Agency, as well as the United Housing Foundation and its officers, engaged in a massive swindle designed to bilk widows and orphans out of their life savings. According to respondents, petitioners financed and built the nation's largest middle income cooperative not to provide decent housing for New York's middle income citizens but to line their own pockets with supervisory, financing and legal fees. Respondents even charge, for the first time in this case, that their facts support the inference that unnamed "defendants" received bribes. That kind of baseless allegation characterizes respondents' totally irresponsible presentation of this case.*

In spite of the smokescreen raised by respondents, the issue in this case remains well defined; the state subsidized and regulated non-profit cooperative residences purchased by respondents, which cannot be resold at a profit, are not

* The "Argument" section of the respondents' brief is likewise replete with mis-cited cases and misleading case analysis. *See e.g.*, pp. 10 to 13, *infra*.

securities and should not be subjected to federal laws designed to regulate conduct in the investment marketplace. No amount of distortion or hyperbole can change the fact that respondents purchased homes, not investment stock. No amount of irresponsible charges can change the fact that the State and nonprofit sponsors of Co-op City built and sold low cost housing, not profit-making investment contracts. And no amount of exaggeration can change the fact that the federal securities laws were neither designed nor intended to regulate such a public welfare undertaking.

Respondents' Statement of Facts

Although respondents' distorted description of the merits of their case is irrelevant to the jurisdictional issue before this Court, we cannot leave their baseless claims and record distortions wholly unanswered. We will, therefore, briefly respond to some of respondents' more egregious errors.

1. *The Information Bulletins Did Not "Guarantee" that Increases in Construction Costs Would Not Be Passed on to Respondents* (Resp. Br. 12). Respondents' claim is that they are paying carrying charges in excess of those originally estimated. That is so. The construction price and mortgage increased substantially between 1965 and 1971, and the carrying charges now being paid by cooperative members are higher than those originally estimated in 1965, before construction began. But respondents have grossly distorted the record in maintaining that the early estimates were somehow "guaranteed." Thus, despite their several references to the Information Bulletins, respondents conveniently fail to mention that every Informa-

tion Bulletin distributed by the petitioners repeatedly warned that all contracts and costs were subject to change with the approval of the State through the Commissioner of Housing* and that the plans and specifications were subject to change (167a, 169a, 174a, 175a, 188a, 190a, 194a, 195a). Moreover, even the language quoted by the respondents (Resp. Br. 11) expressly warns that the contract price is subject to addition or deduction for changes made during the progress of construction.

Respondents also fail to mention that as Co-op City's projected carrying charges increased, all subscribers were immediately advised in revised Information Bulletins and in other notices. This information was distributed long in advance of the effective dates of the increases so that people who could not afford them would not undertake them.**

Respondents also fail to note that all cooperative members were always free to rescind their purchases and to receive refunds for their purchase prices. Indeed, between 1965 and 1973, approximately 15,000 subscribers withdrew

* *E.g.*, "All contracts and agreements referred to herein and all project costs are subject to review, audit and final approval by the Commissioner of Housing and Community Renewal . . ., and to such changes as the Commissioner may require or approve" (167a).

** Thus, the prospect of increased carrying charges in 1970 was announced in 1968 (75a, 77a, 101-03a). Respondents acknowledge the 1968 notice in a misleading footnote (Resp. Br. 19 n. 18), but fail to mention that the letter was issued before any Co-op City apartments were even occupied. Ironically, respondents have the gall to assert that this letter "is irrelevant in determining whether Riverbay stock is a security," and see no irrelevancy in the extensive charges of fraud that they reiterate at length. And the 1973 and 1974 increases were announced in 1971 (Affidavit of Martin London sworn to December 19, 1972, ¶11, annexed to Notice of Motion to prohibit plaintiffs' attorney from engaging in unsupervised communications with the class, dated December 19, 1972), at a time when approximately 1/3 of Co-op City's apartments had not yet been occupied (*cf.* 394a).

their memberships and received refunds in full (393a). Several of the named plaintiffs in this action, including Milton and Ellen Forman, have moved out of Co-op City and received full refunds of their purchase prices.*

Respondents skirt lightly around the fact that a large portion of the carrying charge increases complained of was in no way attributable to increases in construction costs. Belatedly, in a footnote, they acknowledge that "[s]ome portion of the latest increases may be attributable to increased costs of operation and maintenance" (Resp. Br. 22 n. 23).

2. *Co-op City Housing Is Subsidized.* Respondents argue that Co-op City housing is not subsidized (Resp. Br. 6 n. 4). Such a claim is patently false.** Pursuant to Section 33 of the Private Housing Finance Law ("Housing Law"), Co-op City receives exemptions from real estate taxes under a formula which reduces those taxes to approximately 20% of what would otherwise be payable. This subsidy amounts to approximately $18 per room per month. Likewise, the mortgage loan made by the New York State Housing Finance Agency is for a term of 40 years, and the average annual debt service rate paid by

* With respect to Co-op City's members, respondents continually refer to them as very young or very old, on fixed incomes, having given up rent-controlled housing and as having invested their life savings in Co-op City (*e.g.*, Resp. Br. 6, 22, 27). That characterization of the Co-op City resident is fantasy. The fact is that the record is silent on the ages of Co-op City's members, where they formerly lived and how much of their "life savings" were invested in their Co-op homes. It should also be noted that not one person has ever lost a penny of his investment in a Co-op City membership.

** Both courts below had no difficulty in recognizing Co-op City as "subsidized" housing (P-A 4-5 and n. 2; P-B 7).

Co-op City amounts to 6.865% (360a). These below-market mortgage costs save Co-op City residents at least $8.50 per room per month.* And Co-op City is exempt from annual New York State and New York City corporate franchise taxes. N.Y. Tax L. §209(4); N.Y. Laws 1974, ch. 732, §2. These subsidies save Co-op City approximately $245,000 per year.**

In addition to these substantial subsidies, which have the effect of reducing Co-op City's carrying charges to nearly one-half of what they would otherwise be, some residents of Co-op City are eligible for further subsidies pursuant to Section 31(9) of the Housing Law. These subsidies, available to those over 62 years of age whose probable after-tax income does not exceed $5,000 per annum, reduce the carrying charges to one-third of the resident's income.

3. *The Price of Co-op City Memberships Was $450 Per Room, Not $5,737 Per Room.* Respondents assert that the price of Co-op City membership is not $450 per room, the amount paid by every cooperative member, but $5,757 per room (Resp. Br. 24). That is not so. Respondents reached that figure by dividing the total construction cost by the number of rooms in the development. But that result is not the price paid for membership in the cooperative. The

* This projected saving is based on a comparison with the annual cost to Co-op City of a conventional 25 year, 7½ percent mortgage. Comparison with an 8% or 8½% mortgage would obviously result in a larger savings. Even more importantly, it is doubtful that a $390,000,000 mortgage could have been obtained at any cost from conventional mortgage lenders.

** A bill to provide further subsidies to residents of Co-op City and other similar cooperatives is now pending in the New York State Legislature. *See* S. 4508A (1975-76 Reg. Sess.). This bill would provide for substantial annual appropriations to offset mortgage interest charges.

total equity requirement for membership is, and always has been, $450 per room. Cp. 172-73a with 193a.*

4. *Petitioners Did Not Profit from the Construction of Co-op City.* Portraying the petitioners as seeking to advance their own financial interests, respondents describe "profit" allegedly realized by some of the petitioners (Resp. Br. 30-32) and thereby grossly mischaracterize the state-approved fees paid to those petitioners for services rendered in connection with the development.

For example, the fees paid to Community Services, Inc. —which acted as general contractor and sales agent during the eight-year period of construction of Co-op City—was, in fact, but a fraction of the amount customarily allowed by the State for developments under the Housing Law. Indeed, it is doubtful that CSI's costs were even covered by the fees it received. And the supervisory and financing fees paid to the State and the Agency were in strict ac-

* It is highly misleading, indeed, irresponsible, to include mortgage amortization (over a 40 year period in this case) as a part of the price of cooperative membership. No member paid or obligated himself to pay mortgage amortization for forty years. His only obligation is to pay monthly carrying charges in accordance with the terms of his lease.

With regard to the price of Co-op City shares, we should note that respondents do not claim that their memberships are worth any less today than they paid for them, and, of course, they are worth precisely what was paid for them. Instead, respondents seek to obtain the "benefit of the bargain" they claim petitioners promised. It is well-settled that such "contract" damages are not available under the securities laws. *See, e.g.*, Levine v. Seilon, 439 F.2d 328 (2d Cir. 1971). Recognizing this point, the Court of Appeals not only refrained from commenting on the substance of respondents' charges, but also refrained from indicating any conclusion as to whether their complaint even states "claims for which relief can be granted or whether any damages are cognizable . . ." (P-A 8).

cordance with regulations issued under legislative authorization. To suggest that those fees are designed to make the State and Agency a profit, rather than to cover their costs, is absurd. Likewise, the fees paid to the attorneys for their extensive legal work over a ten-year period can in no way be characterized as "profit." Moreover, there is no allegation that such fees are not reasonable compensation for legal services rendered.*

Perhaps the most irresponsible and malicious charge respondents advance is that "defendants" leased Co-op City commercial space at less than fair value "in consideration for extrinsic benefits" (Resp. Br. 32). That charge, made without a shred of record support and, indeed, never before even hinted in this litigation, unjustly impugns the integrity of a number of state officials as well as the individual petitioners and accurately reflects the unseemly lengths to which respondents will go to advance their cause.

5. *The Information Bulletins Did Not Promise Profits to the Members.* Respondents' claim that Co-op City's Information Bulletin promised them profits (Resp. Br. 25-27) is belied by the language of the Bulletins themselves. Far from promising financial profits, those Bulletins emphasize the social benefits which will accrue to cooperative members in a cooperative community (*e.g.*, 162-63a, 187a). Cash income, interest, dividends, or other forms of investment income were at no time used as inducements to membership in Co-op City.*

* It is astounding that respondents can even impliedly challenge this legal fee when they themselves raised nearly $150,000 for their attorney in this case before the complaint was even filed. *See* Opinion and Order with respect to communications between plaintiffs' attorney and the class, Pierce, J., March 7, 1973.

But respondents point to the fact that the Information Bulletin mentioned the possibility of rent rebates which, they suggest, is a form of "profit" (Resp. Br. 25-26). That is wrong. Such rebates, if paid, will simply represent a refund of that portion of the rent already paid by each member which exceeds his aliquot share of the cooperative's expenses. That is no more "profit" than a refund from the grocery store or telephone company. It is not even remotely akin to investment income like dividends on corporate stock or interest on bonds.**

* Indeed, as the District Court found:

> "[N]one of the documents involved in this transaction . . . ever once use material, tangible profits as an inducement. In fact, the Information Bulletins assert the contrary, impressing upon the potential purchaser the stability of environment to be achieved because the shares cannot be used for speculation. . . . Further, since these shares pay no dividends, contemplate no apportionment of any profits or assets or earnings of any kind, it is clear that the Co-op City residents did not purchase the shares with any expectation of profits, as the word is generally used in commerce" (P-B 21-22; footnotes omitted).

That finding was not disturbed by the Court of Appeals.

** Respondents also urge that Riverbay can pay dividends, citing Housing Law §28 (Resp. Br. 29, 50). But the Section 28 dividend provision is obviously intended to allow a 6% dividend for investors in rental housing: among other things, Section 28 provides that the 6% dividend accrues annually and that all accumulated past-due dividends must be paid. This is clearly inapplicable to a cooperative project. Respondents also claim that the Co-op City memberships entitle the members to share in assets on dissolution, *id.*, but neglect to mention that dissolution (a) requires that the $390,000,000 mortgage indebtedness be paid in full; (b) results in termination of all real estate tax exemption; and (c) cannot be accomplished until twenty years after the project was occupied unless the Commissioner of Housing consents. Housing Law §35(2), (3). It is inconceivable that the members of Co-op City would vote to dissolve or that they ever contemplated this option. *See also* Housing Law §36.

Respondents also argue that there exists the possibility of capital appreciation of their cooperative memberships, which they urge, might be sold at a profit (Resp. Br. 29-30). That is sheer nonsense. The Co-op City by-laws, and the Housing Law, absolutely forbid resale of cooperative memberships at a profit, even in a default sale. As to this, both the District Court and the Circuit Court were in full agreement.*

* * *

Although the list of "facts" which respondents maintain are "admitted" could go on and on, we shall not further belabor the record. Respondents made similar presentations below—both in the District Court and in the Court of Appeals—and both courts expressly disclaimed any inference or suggestion of an opinion with respect to the merits. The respondents' lengthy description of the alleged merits of their case is irrelevant. It is also distorted and misleading. Their efforts to smear the petitioners are irresponsible and have no place in briefs filed in any court.

ARGUMENT

A. This Court Has Consistently Rejected the "Literal Approach" to Statutory Construction.

Respondents rely upon several decisions of this Court in urging that the literal approach to statutory construction adopted by the Court of Appeals be affirmed. Without extended discussion, we respectfully submit that the cases principally relied upon by the respondents—*SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) and *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967)—contain no support for their literal approach. Indeed, as pointed out in our principal brief, those cases clearly reject respondents' form over substance arguments (UHF Br. 20-21, 24). This Court clearly enunciated the controlling standard in *Tcherepnin*:

> "[I]n searching for the meaning and scope of the word 'security' in the [1934] Act, form should be disregarded for substance and the emphasis should be on economic reality." 389 U.S. at 336.

Among many miscitations and distortions contained in respondents' brief, their one-sentence quotation from this Court's decision in *United States* v. *American Trucking Ass'ns, Inc.*, 310 U.S. 534, 543 (1940) (Resp. Br. 34) is particularly misleading. Far from advocating a literal approach to statutory construction, the full statement by Mr. Justice Reed makes it clear that he was saying exactly the opposite:

> "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases we have followed their plain meaning. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at

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* The Court of Appeals stated, "Initially it must be conceded that there is no possible profit on a resale of the stock" (P-A 15-16). Moreover, the District Court noted, "The beneficial purposes of the Mitchell-Lama Act would be ill-served if a tenant . . . was to be free to transfer his stock . . . to the highest bidder or in other ways to manipulate his interest to produce a personal profit" (P-B 23 n. 38).

> variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words. When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.'" *Id.* at 543-44; footnotes omitted.*

Similarly, the numerous Court of Appeals decisions which reject the literal approach advocated by respondents and hold that not every "note" is a "security" cannot be dismissed with a passing comment in a footnote (Resp. Br. 40 n. 40). And, contrary to respondents' assertion in that footnote, none of the note cases cited by respondents involved "consumer credit transactions" or "personal loan[s]." All of the transactions involved loans for business use.**

* Examples of other liberties respondents have taken with this Court's decisions include their discussion of the decision in Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972). Respondents assert that this Court "held" the shares of stock in Ute to be securities (Resp. Br. 39). No such holding is to be found in that decision. Indeed, it does not appear that the issue was even raised. Moreover, the stock in that case was not even remotely like the cooperative memberships here; the stock in Ute represented interests which included valuable oil, gas and mineral rights (406 U.S. at 136). Indeed, because of the value of the underlying assets, those shares rapidly appreciated in market value after their issuance.

** Respondents' additional distinction of those cases based on language in Joiner that "this court held that the statutes [securities laws] would apply if the 'novel, uncommon or irregular devices . . . were widely offered'" (Resp. Br. 40 n. 40) is a particularly outrageous misuse of the language in that opinion. This Court actually held:

> "Novel, uncommon or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a security.'" 320 U.S. at 351.

This Court has, in short, never accepted the so-called literal approach to statutory construction, and it should not do so here. Co-op City is not an investment venture. Indeed, as the District Court appropriately noted, any possibility of investment or speculation would effectively destroy the salutary purposes of the Housing Law (P-B 22-23 and n. 38). A Co-op City resident purchases his membership solely for the right to live in an apartment which cannot be sold at a profit and which carries a below market rental made possible by substantial state and city subsidies. It is plainly a transaction remote from the world of investment and commerce which the securities laws were intended to regulate.

B. The Blue Sky Laws Are Irrelevant.

Respondents incorrectly argue that "[a]ll of the states active in cooperative housing treat cooperative stock as securities under their respective State blue sky laws," citing New York, California, Florida and Illinois (Resp. Br. 46). The same point was briefed below. Petitioners responded then and respond now, by citing *Brothers* v. *McMahon*, 351 Ill. App. 321, 115 N.E.2d 116 (1953), and *State* v. *Silberberg*, 166 Ohio St. 101, 139 N.E.2d 342 (1956), which support petitioners' view.*

* It should be noted that respondents' claim that Congress intended to "cover all securities subject to the existing blue sky laws of 47 states" (Resp. Br. 42) is not supported in fact. The pages of H.R. Rep. No. 85 which they cite refer to proposed Section 18, making it unlawful to use facilities of interstate commerce to sell or deliver securities in violation of state law. *Id.* at 25. The section was not enacted. The cited pages of S. Rep. No. 47 express criticism of State blue sky laws and an intention not to exempt securities merely because they are subject to them.

However, it serves no useful purpose to make a "head count" of state decisions.* The fact is that state court decisions with respect to which state statute or state agency is to govern sales of cooperative apartments are based on entirely different considerations than those before this Court.** Moreover, the state statutes are so varied as to be of no probative significance. In this regard, the New York law is a good illustration.

The original New York "blue sky" law, enacted in 1921, is now contained in Section 352 of the General Business Law. It covers "stocks, bonds, notes, evidence of interest or indebtedness or other securities." It vests regulatory jurisdiction in the state Attorney General. But despite the breadth of its definitional language, it is not used to regulate cooperatives.

Instead, the sale of cooperatives in New York is covered by Section 352-e of the General Business Law, adopted in 1960. Section 352-e covers real estate syndications, "including cooperative interests in realty." It covers all

* The respondents also urge a "head count" of commentators (Resp. Br. 47-48). But they distort Professor Loss's views by citing his treatise to support a literal approach, see 1 Loss, Securities Regulation 492-94 and n. 103 (1961); and they ignore many articles rejecting the view that housing cooperative "stock" is a security, *e.g.*, Dickey and Thorpe, Federal Security Regulation of Condominium Offerings, 19 N.Y.L. Forum 473 (1974); Coffey, The Economic Realities of a 'Security': Is There a More Meaningful Formula?, 18 W. Res. L. Rev. 367, 399-400 (1967); Miller, Cooperative Apartments: Real Estate or Securities?, 45 Boston U.L. Rev. 465 (1965).

** Policy considerations under the federal securities laws include the potential supplanting of the substantive laws of 50 states by a single national law, the opening of federal courts to virtually all disputes arising out of transactions in cooperative homes and the application of the vast regulatory authority of the SEC.

condominiums as well, whether the primary motive of the purchasers is residence or profit from subletting. *See* N.Y. Real Prop. L. §339-ee. In some places it refers to such syndications, including all cooperatives and condominiums, as securities. It also vests regulatory jurisdiction in the Attorney General. Thus, in New York, there is a specific statute expressly regulating sales of cooperatives, condominiums and other forms of real estate syndications, separate and apart from the general blue sky law regulating stocks and bonds.

C. Respondents Have Misapplied the *Howey* Profit Test.

This Court has long held that the inducement and promise of financial return on one's investment, the lure of money profits, is an essential element of an investment contract. Respondents ask this Court to expand that rule to include the novel profit theory adopted by the court below: that savings in rents made possible by government subsidies, incidental income from commercial facilities, and personal income tax deductions routinely available to all home owners, consitute the kind of "profit" which creates a security in the form of an investment contract.

As set forth above, *see* p. 10, *supra,* and in our principal brief (UHF Br. 11-12, 28-32), there can be no profit from resale of Co-op City's memberships. And the modest tax deductions and incidental income from commercial facilities (if any) were never promised or used as an inducement to prospective members and cannot be defined as "profit" by any reasonable standard.

Moreover, the cases cited by respondents simply do not support their novel theory of profit. For example, *Davenport* v. *United States*, 260 F.2d 591 (9th Cir. 1958), *cert. denied* 359 U.S. 909 (1959) involved an appeal from a conviction of conspiracy to commit mail and securities fraud. The entity involved was to be a plywood manufacturing cooperative—a business enterprise designed to make money for its shareholders. No issue as to the definition of a security was even mentioned in the decision. Respondents' assertion that the Court of Appeals "found that the mere expectation of employment and job security was sufficient to make a certificate of membership in a cooperative a 'security'" (Resp. Br. 52) is thus patently false. *State ex rel. Troy* v. *Lumbermen's Clinic*, 186 Wash. 384, 58 P.2d 872 (1936), was a *quo warranto* proceeding under Washington law to determine whether the charitable enterprise could provide medical services to businesses for a fee. Respondents' remaining cases, which involve definitions of "nonprofit" in the context of state laws covering incorporation or tax exemption of non-profit entities, are equally inapposite.

In addition to citing decisions which are not even remotely in point, respondents blindly ignore the plain fact that virtually the entire "profit" they claim Co-op City members receive flows from the very substantial government subsidies provided by the State and City. Those subsidies are no more investment "profit" than are savings from food stamps, where a person pays money and receives documents entitling him to obtain more than his money's worth of food from the grocery store. Here, respondents have paid money to receive a certificate entitling

them to more than their money's worth of housing. Clearly, both the food stamp and the housing "stamp" provide public subsidies, not "investment contract" profit.

D. The "Risk Capital" Approach Advanced by Respondents Would Stretch the Securities Laws Far Beyond What Congress Intended.

Respondents also ask this Court to abandon entirely the profit requirement of *SEC* v. *W. J. Howey Co.*, 328 U.S. 293 (1946), and to replace it with a so-called "risk capital" approach, which would make an investment contract out of every transaction in which, although there is no expectation of monetary return, "there is the element of risk capital coupled with some economic benefit" (Resp. Br. 53-54).

But application of that approach to the facts of this case is not supported by the cases respondents have cited and would expand the scope of the securities laws far beyond their intended coverage.

Nearly all of the cases respondents cite involved promises of direct monetary profits as a principal inducement for entering into the transactions at issue. For example, the long string of cases cited on p. 56 of respondents' brief all involved pyramid or franchising schemes in which investors were lured by the promise of substantial return on their investments. *See, e.g., Venture Investment Co., Inc.* v. *Schaefer*, 3 Blue Sky L. Rep. ¶71,031 (D. Col. 1972), *aff'd* 478 F.2d 156 (10th Cir. 1973) (involving false representation that franchiser had written up $8,000-$10,000 worth of business each month in same-size area; Colorado

law applied); *Murphy* v. *Dare to Be Great*, 3 Blue Sky L. Rep. ¶71,053 at 67,281 (D.C. Super. Ct. 1972) (pay $1,000, enroll three members, "and then just sit back and watch the money roll in").

Respondents' reliance upon the California Supreme Court decision in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P.2d 906 (1961) is also misplaced. There, the Court was construing a California statute which did not require profit as an element of a "security." *Id.* at 908. Furthermore, the cost of the club memberships would increase after the club was started. Because the memberships were transferrable, members would be in a position to realize a direct cash gain upon their sale. As one commentator has noted, "The *Silver Hills* fact pattern contains an element of expected profits." Coffey, *supra*, 18 W. Res. L. Rev. at 400 n. 143.

El Khadem v. *Equity Securities Corp.*, 494 F. 2d 1224 (9th Cir.), *cert. denied* —— U.S. —— (1974) is also inapposite. It arose in a purely investment context and involved a complex margin scheme whereby the plaintiff borrowed money from defendant Nationwide to purchase securities, pledging those and other securities of 175% of the value of the loan as collateral. Nationwide rehypothecated the collateral, which was ultimately lost. It was, in short, an investment scheme that went sour. The facts are not even remotely similar to this case.

In summary, the risk capital theory advanced by respondents is simply not supported by any of the cases they cite. Moreover, even if there were case support for respondents' "risk capital" argument, Co-op City's memberships, as to which there is practically no risk of loss* and no possibility of profit, are simply not the kinds of interests which would qualify as securities under it. Finally, it is apparent that the risk capital approach advocated by respondents is fundamentally inconsistent with the intended scope of the securities laws and the definitions of "security" long established by this Court. Under respondents' approach, for example, every executory contract in which the purchaser advanced all or part of the purchase price would be a security. But that absurd result was intended by Congress no more than it intended to include Co-op City's non-profit shares within its securities legislation.

E. Respondents' Investment Contract Theory Conflicts with Current SEC Regulations.

Whether SEC Release 33-5347 was intended to cover both cooperatives and condominiums, as argued by petitioners, or was only intended to cover condominiums, as argued by respondents, a fundamental inconsistency exists between the investment contract theory advanced here by the respondents (and adopted by the Court below) and the investment contract theory set forth in the Release.

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* Respondents' risk is extremely limited by statute and the State's supervisory involvement. By statute, foreclosure by a private party is substantially restricted. Housing Law §§34, 94, 95. While foreclosure by certain state agencies, including the New York State Housing Finance Agency, is not so restricted, the Commissioner of Housing must be made a party and "shall take all steps necessary to protect the interests of the public . . . ." Housing Law §§34, 94(2). During the construction of the project, the State could, and did, advance additional funds to ensure completion. No development financed under the Housing Law has ever failed to complete construction, gone bankrupt or been foreclosed. No cooperative member has ever lost his investment in a cooperative built under the Housing Law.

Briefly put, if the economic benefit of good housing at low cost, or personal income tax deductions, is a "profit" when the housing is a cooperative, as the respondents argue, is it not also a "profit" when the housing is a condominium? And if placing capital at "risk" in a housing cooperative creates a security, does it not also create a security when the housing is a condominium?

It is apparent that the arguments advanced by respondents would make every condominium a "security" and would thereby erase the careful distinction between purchases for residential use and purchases for investment profit which is elaborated in SEC Release 33-5347, and in the Advisory Report that preceded it.* *See also* Berman & Stone, *Federal Securities Law and the Sale of Condominiums, Homes and Homesites*, 30 Bus. Lawyer 411, 420-24 (1975) (recognizing this inherent conflict between SEC Release 33-5347 and the decision below).

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* Indeed, that sound distinction finds support, *inter alia*, in the language of this Court in *SEC* v. *W. J. Howey Co.*, 328 U.S. at 299-300:

> "The respondent companies are offering something more than fee simple interests in land, something different from a farm or orchard coupled with management services. They are offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise . . . . They are offering this opportunity to . . . persons [who] have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment";

and *SEC* v. *C. M. Joiner Leasing Co.*, 320 U.S. at 352 n. 10,

> "One's cemetery lot is not ordinarily thought of as an investment and is most certainly real estate. But when such interests become the subjects of speculation in connection with the cemetery enterprise, courts have held conveyances of these lots to be securities."

See also UHF Br. 32 and n. 26.

Petitioners submit that the distinctions drawn in SEC Release 33-5347 are sound and correctly state the underlying legal principles applicable to condominiums and (whether or not so intended by the SEC) to cooperatives as well. No reason has been advanced to justify treating them differently. None exists.*

Conclusion

Respondents are seeking an unjustified and unprecedented expansion of the scope of the federal securities laws. Their argument, in substance, is that because they invested money and because they alleged fraud in their complaint, the securities laws apply and their suit may be maintained in a federal court.

That argument cannot be accepted. As we pointed out in our principal brief, the securities laws are not a catchall for disparate complaints and problems. The securities laws are designed to protect investors in the commercial marketplace, not consumers seeking housing; they cover trans-

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* As described in our principal brief (*e.g.*, UHF Br. 42-43), Congress continues to treat cooperatives and condominiums alike. Both are treated as residences, not investment securities. A recent example is Section 208 of the Tax Reduction Act of 1975, P.L. No. 94-12, Mar. 29, 1975. Section 208, designed to combat the economic decline in the housing industry, provides for a tax credit on the purchase of a "new principal residence" defined as:

> "a principal residence (within the meaning of section 1034), the original use of which commences with the taxpayer, and includes, without being limited to, a single family structure, a residential unit in a condominium or cooperative housing project, and a mobile home."

Congress is obviously not subsidizing investments in "securities" but purchases of "housing." Other illustrations not previously noted appear in Internal Revenue Code §§121(d)(3), 1034(f).

actions in investment securities, not transactions in personal residences.

Accordingly, we respectfully submit that the decision of the court below should be reversed and the complaint dismissed for lack of federal subject matter jurisdiction.

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Respectfully submitted,

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